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SUBJECT: Belarus Makes and Russia Loses Billions on Oil

Refs: (A) Minsk 364, (B) Minsk 381

¶1. Summary: During a recent seminar an energy expert from Belarus' Ministry of Economics explained that Belarus buys crude oil from Russia for well below market rates. With current high oil prices the GOB stands to benefit by USD 3.9 billion this year (14% of GDP), while the Russian budget could lose USD 3.5 billion on lost oil export duties. However, the expert does not expect these prices to go up, as Russian oil companies make an additional USD 370 million selling to Belarus, and these companies are proficient in lobbying the GOR to allow such pricing and sales. In addition, the expert confirmed that Moscow is pressing Minsk to raise oil export duties to Russian levels and to reimburse the Russian budget for previous losses for Russian crude imported to Belarus duty-free and charged Belarusian duties upon re-export. He estimated that if Minsk were forced to match its duties to Russia's, Belarus' refineries would become unprofitable. End summary.

¶2. On April 19, Econoff attended a seminar on Belarusian trade policy. Aleksandr Gatovsky, an analyst with the Ministry of Economics Economic Institute, described in detail the factors affecting the reduced price Belarus pays for Russian crude oil imports. In 2005 Belarus imported 19.3 million tons of Russian crude oil, up from 17.8 million tons in 2004. Belarus additionally produced 1.8 million tons of oil from domestic sources in 2005.

Cheap Oil: Minsk and Russian Business Win, Moscow Loses

¶3. According to Gatovsky, in January Belarus paid USD 32 per barrel for Russian crude. This compared to a world price for Urals crude of USD 59.50/barrel. A main reason for Belarus' discounted price is that Russian exporters do not pay Russian oil export duties for crude shipped to Belarus. Russia charged USD 53.90 (including export duties) for exports to other CIS states -- this price was USD 29.30/barrel before the addition of Russian export duties and excise taxes. Using January 2006 prices and the amount of oil Belarus imported in 2005, Gatovsky estimated that Belarus could benefit to the tune of USD 3.9 billion this year from Russian crude priced below market levels. Of that amount, USD 813.7 million now goes to the GOB in the form of VAT payments, since Russia and Belarus switched to the country of destination principal in VAT in January 2005.

¶4. Because exporters do not pay Russian oil export duties on crude exported to Belarus, the Belarusian Ministry of Economy calculated that the Russian budget could lose USD 3.5 billion this year on oil exported through Belarus (USD 24.6/barrel, or USD 180/ton).

¶5. Despite these high Russian losses, Gatovsky claimed the GOB does not expect Russia to raise the price it charges Belarus for crude. He argued that Russian exporters earn USD 32/barrel selling to Belarus, and only USD 29.30/barrel selling to other CIS states (the price before oil duties are added). Therefore, Russian exporters stand to earn an additional USD 370.6 million this year on exports to Belarus above what they could earn selling to other CIS states (and USD 1.49 billion more than they could make selling domestically in Russia). Gatovsky said the Russian companies exporting to Belarus are fully proficient in lobbying Moscow to keep this situation as is, even though it results in a serious net loss to the Russian budget. [Note: He also stated that Russia only has one natural gas exporter to Belarus, Gazprom, which is effectively a GOR entity. Therefore Moscow finds it easier to raise gas prices for Belarus than it does oil prices.] Gatovsky added that Russian dependence on Belarusian oil pipelines would also serve to curb any price increases.

Russia Dependent on Belarusian Oil Pipelines

¶6. Unlike the situation with natural gas, where only 20% of Russian gas exports transit Belarus (versus 80% through Ukraine), Gatovsky explained that Russia is dependent on Belarusian pipelines. The Druzhba pipeline system, which transits Belarus, carries 21.1% of all Russian crude oil exports, representing nearly all Russia's overland crude exports. Gatovsky said that the new oil terminal in St. Petersburg is a means for Russia to decrease its transit dependence on Belarus.

¶7. However, this dependence only goes so far. Gatovsky said that even though the GOB owns the Druzhba pipelines inside Belarus, in the case that Russia raised oil prices, he did not think the GOB could raise oil transit prices to match. Gatovsky stated that oil transit prices are set according to international norms, and that Minsk would not be able to justify any sharp increase.

Moscow Pressing Minsk on Duties

¶8. Gatovsky confirmed an April 10 Russian newspaper Kommersant article that in late March the Russian government sent a letter to the GOB insisting Belarus implement Article 4 of the Russia-Belarus Customs Union Treaty of 1995, and for Minsk to reimburse Moscow for money lost from Belarus earning oil export duties on Russian crude imported duty free. Article 4 literally calls on Russia and Belarus, as well as Kazakhstan, to implement "a single order for regulating external economic activity." Elena Rakova, energy specialist with the Institute of Privatization and Management, explained to Econoff that Russia argues Article 4 stipulates the two countries share the proceeds from Belarusian oil export duties on Russian crude imported duty free, and that now Moscow wants to be reimbursed for lost revenue. Rakova claimed that several years ago the GOB unilaterally decided that Belarusian refineries add enough value to Russian crude to justify Minsk keeping the entire sum of export duties. Gatovsky admitted that under the treaty Belarus must share a portion of its oil export duty revenue with Russia, but claimed that Minsk has never given Moscow any of this money. In response to a question, Gatovsky refused to answer what share of oil export duties the GOB is obligated to give Russia.

¶9. Gatovsky admitted that recently Moscow has been pressuring Belarus to raise its oil export duties to the level of Russia's and for Minsk to reimburse the Russian budget for losses caused by Belarus' lower oil export duties. Despite recent press announcements to the contrary (ref A), he explained that Belarus still charges considerably lower oil export duties than does Russia. In January, Belarus' duties on crude export were 77.4% lower than Russia's, for diesel fuel, gasoline and kerosene it was 76.5% lower, and for heating oil 34.4% lower. Belarus' weighted average for oil duties (crude and refined oil products) was USD 48.60/ton, compared to USD 180/ton in Russia.

Equal Duties Would Hurt Belarusian Refining

¶10. Gatovsky explained that Belarus' duties were lower to boost demand for Belarus' two refineries. He argued that if duties go up to match Russian levels, refining in Belarus could not compete with Russia, demand for Belarusian oil products would drop, and the Belarusian budget would lose a major source of revenue. Using January 2006 figures, Gatovsky claimed that Belarus pays USD 234/ton of crude and the GOB adds an average of USD 42 in duties on the exported refined oil products (this differs from the figures above since it excludes duties on crude exports). Russian refineries buy crude for USD 157/ton and Moscow charges USD 93.60/ton in duties. Even with higher Russian duties, Russian refined oil products now cost USD 25.40/ton less than do similar Belarusian products. This difference would grow if Belarus were forced to charge the same duties as does Russia, resulting in Belarus' refineries -- one of the GOB's largest sources of revenue -- becoming unprofitable.

Oil Very Profitable for Minsk, Now

¶11. Gatovsky stated that 81% of Belarus' 2005 growth in exports was caused by the growing volume and cost of oil product exports. Oil and oil products now make up one-third of all Belarusian exports. Independent media sources claim that oil exports are managed by trading houses under the control of the Presidential Administration's Property Management Department and the state concern Belneftekhim. In late March, Lukashenko ordered that Belneftekhim be placed directly under the control of his Presidential Administration (septel), giving him greater control over this lucrative revenue stream. Gatovsky gave one example of how the GOB profits from the oil trade. He explained that the GOB uses profits from the sale of lubricants refined at the state-owned Naftan refinery to pay salaries and operating costs. The GOB uses the profit from Naftan's refining of gasoline, diesel fuel and mazut to support various unprofitable state-owned enterprises. The GOB also uses other oil revenue for "investment" as well. For instance, profits from the state-owned oil companies Belarusneft and Gomeltransneft Druzhba were used to fund Euro 47.9 million in modernization at the state-owned Belshina tire company.

¶12. According to the World Bank's Minsk office, Belarusian exports of oil and oil products grew 400% between 2001 and 2005. In 2005 such exports made up 16.4% of GDP, 30% of all exports and 63% of exports to the European Union. This despite the fact that Belarus itself must import 93.6% of its domestic oil needs.

Comment

¶13. Belarus is in perhaps the unique position of being almost entirely dependent on imported oil, but massively benefiting when oil prices rise. In the past several years the GOB has invested heavily in its two refineries, and now oil products are the country's largest export and the GOB's largest cash cow. While domestic lobbyists may prevent Russia from raising prices on crude oil, Moscow seems intent on recouping some of its massive losses caused by Minsk importing Russian crude duty free and earning both revenue and export duties on its re-export. As with natural gas (ref B), Minsk may be about to fall off the energy gravy train.

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